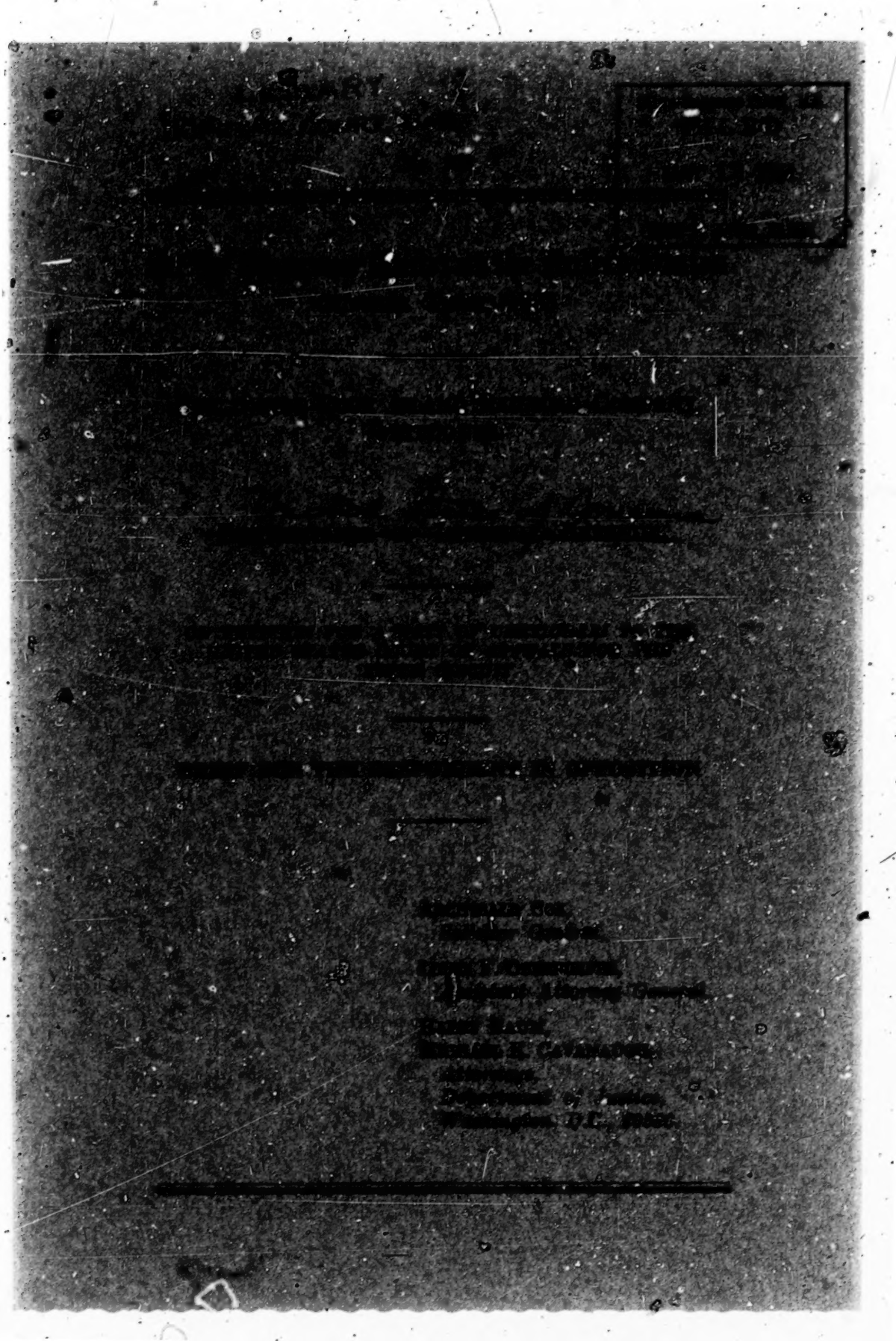

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 940

BURLINGTON-ROCK ISLAND RAILROAD COMPANY,
PETITIONER

v.

~~COMMISSIONER OF INTERNAL REVENUE~~ United States of America

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (R. 32-41)[1] is reported at 200 F. Supp. 681. The opinion of the court of appeals (Pet. 15-26) is reported at 321 F. 2d 817.

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[1] Citation is to the Transcript of Record in the court of appeals which is on file with the Clerk of this Court.

JURISDICTION

The court of appeals entered judgment on August 27, 1963 (Pet. 27), and denied the taxpayer's petition for rehearing on December 27, 1963 (Pet. 28). The petition for a writ of certiorari was filed on March 23, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below properly held that petitioner, an accrual basis taxpayer, did not have a fixed and unconditional obligation in the taxable year 1954 to pay interest accrued as a deduction in that year.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 163. INTEREST.

(a) *General Rule.*—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

* * * * *

SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

(a) *General Rule.*—The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

Sec. 1.461-1. *General rule for taxable year of deduction.*—

(a) *General rule*—

* * * * *

(2) *Taxpayer using an accrual method.* Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. * * *

* * * * *

STATEMENT

The Burlington-Rock Island Railroad Company initiated this action in the district court contending that it was entitled to a deduction for the taxable year 1954 for interest which had not been paid, on the ground that the interest was properly accruable during that year (R. 32). The district court found that the obligation to pay the interest was subject to a series of contingencies, and hence did not constitute a definite, fixed and existing obligation to pay (R. 32-41). Accordingly, it upheld the Commissioner's determination that the taxpayer was not entitled to accrue and deduct the interest claimed in that year (R. 32-41). The court of appeals affirmed (Pet. 15-26).

The facts may be summarized as follows: In 1905 and 1906, all of the outstanding capital stock and first mortgage bonds of the taxpayer were acquired

in equal amounts by the Colorado and Southern Railroad ("Southern") and the Chicago, Rock Island and Pacific Railroad ("Rock Island"). In 1914 the taxpayer went into receivership which was not terminated until 1931. During the course of this receivership, the two creditor-shareholders acquired all of the receiver certificates which amounted to $1,489,954.40, and forgave all accumulated interest on the certificates which amounted to $11,641,785.89 (R. 33-34; Pet. 16).

In 1946, Southern and Rock Island sued the taxpayer in the United States District Court for the Southern District of Texas. The court rendered equal judgments in favor of the two stockholder-creditors in a total amount of $19,659,841.66. Of this sum, $8,760,000 represented unpaid principal of the bonds acquired in 1905 and 1906, $1,489,954.40, the unpaid principal of the receiver certificates, and $9,409,890.26, the unpaid interest which had accrued on the bonds and certificates. By statute, the judgments bore interest at the rate of six percent per annum. 15 Vernon's Texas Civil Statutes Annotated, Art. 5072 (R. 33-34; Pet. 16).

During 1950 the taxpayer ceased to be an operating railroad and leased its lines to a subsidiary of Southern and Rock Island for an annual rental of $375,000 plus additional charges (Pet. 4-5). On June 1, 1950, taxpayer entered into an agreement (R. 29-32) with its two creditor-shareholders with respect to the judgments against it. This agreement, which was terminable on thirty days' notice by either party, provided

that the taxpayer would make payments on the judgments "from time to time insofar as its cash situation will reasonably permit." Any sums so paid were to be credited first against the principal amount of the receiver certificates ($1,489,954.40); then against the principal amount of the first mortgage bonds ($8,760,000); then against the unpaid interest on these two securities ($9,409,890.26); and finally against the interest payable on the judgments—the interest here in question. Between 1950 and 1954 the taxpayer paid $1,153,761.87 to its two creditors-shareholders under this agreement (R. 34-35, 37-38; Pet. 17).

In 1954, the tax year in question, the taxpayer had income of $471,888.63. Offsetting this income it claimed an accrued interest deduction of $1,119,716.38 which represented statutory interest on the unpaid balance of the judgments (Pet. 47).

ARGUMENT

The decision below is correct. There is no conflict of decisions and no occasion for review by this Court.

1. It is well settled that to accrue an item of deduction during the taxable year, all events must have occurred in that year which fix the amount and the fact of the taxpayer's liability to pay the obligation. *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *Lucas* v. *American Code Co.*, 280 U.S. 445; *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516; *United States* v. *Consolidated Edison Co.*, 366 U.S. 380; Section 1.461-1 of Treasury Regulations on Income

Tax (1954 Code) (*supra*, p. 3). Moreover, to be entitled to accrue interest, the taxpayer must establish not only that there is a present indebtedness, but also that it has a present liability to pay interest on the indebtedness.

As the court of appeals noted (Pet. 18), "Neither party seriously disputes the basic principles of tax accounting applicable in this case." Rather, the taxpayer challenges the holding of the district court (R. 36) and court of appeals (Pet. 15-16) that on the facts of this case it did not have a fixed and unconditional obligation in 1954 to pay the interest in question (Pet. 10). There is, however, no basis for this challenge. Under the terms of the allocation agreement, the taxpayer was required to make payments (R. 30), "from time to time, insofar as its cash situation will reasonably permit" (R. 36, Pet. 23). Such an agreement under Texas law imposes merely a conditional obligation on the debtor to pay and no legal duty to make payment arises unless his financial situation permits it.[1] Enforcement of such an obligation

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[1] *Guardian Investment Corp.* v. *Phinney*, 253 F. 2d 326 (C.A. 5); *United States* v. *Virgin*, 230 F. 2d 880 (C.A. 5); *Gilman* v. *Commissioner*, 53 F. 2d 47 (C.A. 8).

[2] *Guardian Investment Corp.* v. *Phinney*, *supra*; *Pierce Estates* v. *Commissioner*, 195 F. 2d 175 (C.A. 3); *Prudence Securities Corp.* v. *Commissioner*, 125 F. 2d 340 (C.A. 2); *American Bemberg Corp.* v. *United States*, 150 F. Supp. 355 (Del.), affirmed, 253 F. 2d 691 (C.A. 3), certiorari denied, 358 U.S. 827; *Carlisle Tire and Rubber Co.* v. *Commissioner*, decided October 6, 1947 (P-H Memo T.C., par. 47,269), affirmed, 168 F. 2d 816 (C.A. 3).

requires a showing that the debtor has sufficient funds to make payment.[1]

The allocation agreement further provided that (R. 31) "no amount shall be paid or be deemed to have been paid on the interest" on the judgments until such time as the taxpayer has paid the principal amount of the receivership certificates of $1,489,954.40, the principal amount of the bonds of $8,760,000, and that part of the judgments representing unpaid interest on the receiver certificates and the bonds in the amount of $9,409,896.26 (R. 31; Pet. 17). Since none of these conditions had been satisfied at the close of the taxable year 1954, it is clear that the taxpayer did not have a definite, fixed and existing obligation to pay the interest here in question at that time.

Taxpayer's argument (Pet. 11) that the provision in the allocation agreement that either party could terminate on thirty days' notice neutralized the conditions precedent to its obligation to pay interest is without merit. As the court below pointed out (Pet. 26), the termination clause "merely adds a second, alternative contingency" to the ones in the agreement. Like the others, this contingency had not been fulfilled by the end of the taxable year when the status of the obligation is to be judged for purposes of determining whether it was properly accruable.

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[1] *See Buckley* v. *Finley*, 113 S.W. 2d 133 (Tex. Civ. App.); *Wright* v. *Farmers' Nat. Bank*, 72 S.W. 103 (Tex. Civ. App.). Cf. *Worth Petroleum Co.* v. *Callihan*, 82 S.W. 2d 1060 (Tex. Civ. App.).

2. Nor is there any substance to the taxpayer's contention (Pet. 7-10, 12-14) that the government was precluded from arguing in the court of appeals, in support of the district court's decision, that the allocation agreement amounted to an executory accord under Texas law. In the court of appeals the taxpayer was contending that its stockholder-creditors could have sued on the judgments even while the allocation agreement continued in force (Pet. 7, 21-22), and that therefore it was liable for the interest notwithstanding the agreement. The government's characterization of the agreement as an executory accord was merely a response to this argument. Thus, under Texas law, an executory accord suspends action on the original claim as long as the debtor commits no material breach.[1] In any event, new legal grounds may always be urged and considered in support of an affirmance of the lower court. *Helvering* v. *Gowran*, 302 U.S. 238.

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[1] See *Alexander* v. *Handley*, 136 Tex. 110, 146 S.W. 2d 740; *Worth Petroleum Co.* v. *Callihan*, *supra*; *Thompson* v. *Pechacek*, 365 S.W. 2d 207; Corbin on *Contracts*, Section 1283; 1 Tex. Jur. 2d, *Accord and Satisfaction*, Section 41.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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